UPDATES

Energy & Infrastructure – Legal Milestones in 2019 and a Look Ahead

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This update covers:

1 The Year that Was

The year 2019 was eventful for the Indian energy and infrastructure sector. While the re-opening of signed power purchase agreements by state governments and cancellation of various tenders hampered investor confidence, various structural reforms were proposed by the government to combat the low growth rate of renewable energy generation and ease investment norms for the infrastructure sector.

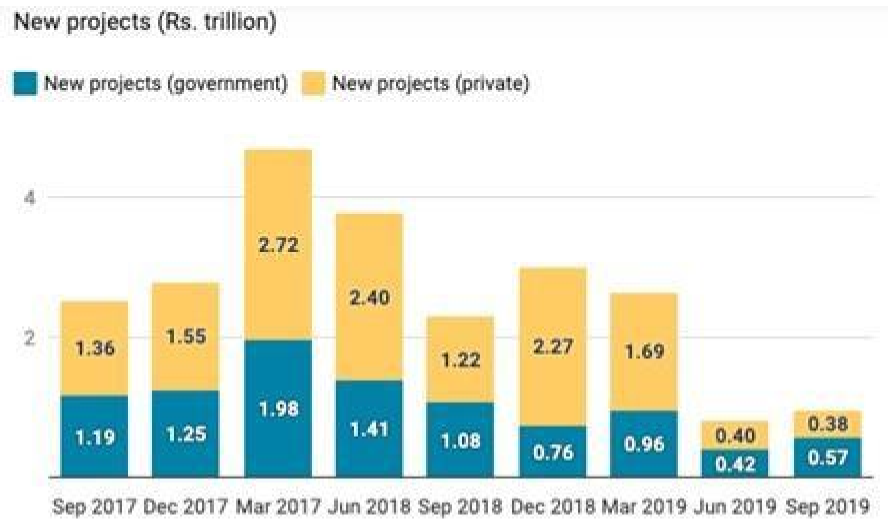
This update summarises some of the key developments in the past year and gives a brief overview of what can be expected in 2020.

Various policy initiatives and regulatory changes brought in by the government in 2019 are hoped to have a positive impact and pave the way for greater investment opportunities in the energy and infrastructure sector in India. This update summarises some of the key developments in the past year and gives a brief overview of what can be expected in 2020.

2 Major Developments in 2019

2.1 Investments in Energy and Infrastructure Sector

Experts estimate that India requires an investment of nearly Rs. 50,000 billion in the infrastructure sector by 2022 to ensure sustainable development at healthy growth rates. However, overall investments in the core sector have declined as compared to previous years, as evidenced by the graph below.



Source: Centre for Monitoring Indian Economy

To counter this, the government has attempted to stimulate investments by having a larger proportion of public sector capital expenditure outlay in the early phases of project development and through corporate tax cuts.

2.2 Renewable Power

According to the Ministry of New and Renewable Energy (MNRE), 7.59 GW of grid-connected renewable energy capacity was added in FY 2019-20, against a target of 11.8 GW, with a cumulative renewable energy capacity standing at 85.9 MW as of December 2019. Whilst impressive in its own right, the shortfall in capacity addition is likely to mean that the government will fall short of its target of installation of 175 GW of renewable energy capacity by 2022, comprising 100 GW of solar power, 60 MW of wind power and 25 MW of biomass and small hydel. According to CRISIL's projections, India will only have 59 GW of solar plants and 45 GW of wind turbines by March 2022.

However, there were some positive policy developments on the policy front in the renewable energy sector in 2019. MNRE issued the Draft Offshore Wind Energy Lease Rules for offshore wind projects. Further, a 150 MW floating solar project on the Rihand dam was awarded by the Uttar Pradesh government. The Central Government also directed state electricity distribution companies (Discoms) to put in place a payment security mechanism for generators.

While these developments were a step in the right direction, certain developments in the sector have hurt investor confidence, such as:

a. Renegotiation of PPAs - In July 2019, the Andhra Pradesh government announced that it would review power purchase agreements (PPAs) signed between Discoms and power generators to renegotiate tariffs, citing poor financial health of Discoms and to reduce the tariffs under the PPAs in line with lower tariffs discovered in recent bids. This has led to the disruption of project development and lending activities in the state.

b. Payment delays - According to the Central Electricity Authority, as of July 2019, Discoms across India owed renewable power producers approximately Rs. 98 billion, with around three-quarters owed by four southern states - Andhra Pradesh, Tamil Nadu, Telangana and Karnataka. To address investor concerns, the Ministry of Power directed Discoms to issue a letter of credit to power generators, which the power generators would be entitled to encash if Discoms delayed payments.

c. Low tariff caps - Setting of low tariff caps in renewable energy auctions has had a deterrent effect on investor interest and participation in bids. For instance, the Solar Energy Corporation of India's 1,200 MW wind tender failed to get the minimum number of bids for the fourth time with a tariff cap of Rs. 2.93.

d. Ad-Hoc cancellation of bids - Since 2018, solar bids of nearly 8 GW have been cancelled by the tendering authority. Bidders incur significant cost in evaluating their opportunities and putting together their bids and such cancellation (without any compensation) adversely affected investor sentiment.

2.3 Boost to Electric Vehicles

India's electric vehicle market is projected to grow at a compound annual growth rate of over 37%, during 2018-2023. A few key developments in the electric vehicle (EV) sector in 2019 are:

a. FAME II - The 'Faster Adoption and Manufacturing of Electric Vehicles in India Phase II' (FAME II) was launched with a total outlay of Rs. 100 billion over a period of three years between 2019 and 2022. Under FAME II, all EVs are eligible for financial support from the government, based on the battery capacity of the vehicle (measured in units of kWh). For electric two, three and four-wheelers and for four-wheeler hybrid vehicles, financial support of Rs. 10,000 for every kWh of battery capacity, subject to a cap of 20% of the cost of the vehicle is available. For electric buses, this support is Rs. 20,000 for every kWh of battery capacity, subject to a cap of 40% of the cost. This financial support is restricted to EVs with prices less than the threshold value of Rs. 150,000 for electric two-wheelers, Rs. 500,000 for electric three-wheelers and Rs. 1,500,000 for electric four-wheelers and hybrid vehicles and Rs. 20,000,000 for e-buses.

b. Revised Guidelines for Charging Infrastructure - The Ministry of Power issued revised Guidelines and Standards for Charging Infrastructure for EVs, which lay down a phased implementation plan for installation of charging infrastructure across cities such that there will be one EV charging station for every 4 km in cities and every 25 km on highways.

c. Reduction in GST rate - The GST rate was reduced from 12% to 5% on EVs and from 18% to 5% on EV chargers.

d. Additional income tax deduction - An additional income tax deduction of Rs. 150,000 on interest paid on loans taken to purchase EVs has been introduced.

e. Incentives - The Central Government has sanctioned Rs. 85.96 billion for incentives to promote EV deployment, of which Rs. 10 billion has been earmarked for setting up charging stations.

Various states have also introduced measures to incentivise the manufacture and purchase of EVs. For instance, Karnataka provides financial incentives including subsidies, low-interest loans, state GST reimbursement, discounts on registration charges, stamp duty exemption and electricity tariff discounts. Karnataka also provides land in clusters to set up EV manufacturing zones. Andhra Pradesh has proposed to provide a research grant of Rs. 5 billion to support research laboratories dedicated to EV and smart mobility research. Another strategy adopted by States is to disincentive conventional vehicle purchases. For example, Delhi has proposed to enact a pollution tax on diesel fuel. The funds collected would be allocated to the State EV fund.

2.4 Changes to Oil and Gas Exploration Policy

The Ministry of Petroleum and Natural Gas has introduced significant changes to India's oil and gas exploration policy to attract private and foreign investment in the sector. Some of the key changes are set out below:

a. Category II & III basins - In basins with no commercial production at present (Category II and III basins), exploration blocks will be bid out exclusively based on the exploration work programme submitted by the bidder, without any revenue or production share to the government. In case of a windfall gain (i.e. when revenue net of royalty from the contract area exceeds USD 2.5 billion in a financial year), the contractor will share revenue with the government on a graded scale ranging from 10% to 50% on the incremental revenue over USD 2.5 billion.

b. Category I basins - For unallocated/unexplored areas of basins with established commercial production (Category I basins), the bidding will continue to be based on revenue sharing but with more weightage given to the exploration work programme (70% weightage to the exploration work programme and 30% weightage to revenue share).

c. Discount in royalty - To incentivise early production, a 10% discount in Category I basins, 20% in Category II basins and 30% in Category III basins will be given if production commences within 4 years for on-land and shallow water blocks, and 5 years for deep-water/ultra deep-water blocks.

d. Marketing and pricing freedom for crude oil and natural gas - The contractor will have full marketing and pricing freedom for crude oil and natural gas to be sold on an arm's length basis through a transparent and competitive bidding process.

e. Incentive for enhanced gas production - To incentivise enhanced gas production, marketing and pricing freedom has been granted for those new gas discoveries whose field development plan is yet to be approved.

f. Private sector participation - To encourage production enhancement and infusion of new technology and capital, state-owned oil companies have been allowed to partner with private sector players.

Recently, the Ministry of Environment, Forest and Climate Change has also exempted the requirement for an environmental clearance for both onshore and offshore drilling explorations. Previously, exploratory surveys merited the highest level of environmental scrutiny as they were classified under category A under the Environment Impact Assessment Notification, 2006, which required project proponents to prepare an environment impact assessment (EIA) report and hold public hearings. Such exploratory surveys will now be categorised under the B2 category which obviates the EIA report and public hearing requirement. However, the development of an offshore or onshore drilling site as a hydrocarbon block will continue to fall under category A.

2.5 New Regime for External Commercial Borrowings

On 16 January 2019, the RBI introduced the new External Commercial Borrowings (ECB) framework, in supersession of its extant master directions.

The new ECB framework has simplified the three-track regime for ECBs into a dual framework governing foreign currency ECBs on one hand, and INR-denominated ECBs on the other. Additionally, masala bonds are also subsumed within the INR ECB framework. To further simplify the process, the following changes have been made under the new framework:

a. the minimum average maturity period for all ECBs is now capped at 3 years, subject to certain exceptions;

b. any entity eligible to receive FDI can also borrow under the ECB framework, as also units in special economic zones, registered societies/ trusts and NGOs;

c. the list of eligible lenders has been revised to cover residents of Financial Action Task Force or International Organization of Securities Commission compliant countries, equity-holding individuals and multilateral financial institutions;

d. the ECB limits have been revised and eligible borrowers can borrow up to USD 750 million through ECBs; and

e. the negative list of end uses for which the ECB may be used remains largely unchanged.

3 Looking Ahead

In the backdrop of the larger global slowdown, the Indian economy is expected to fare better in 2020 than in 2019. The outlook for the energy and infrastructure sector also looks positive in 2020, with the Central Government expected to play a key role in shaping the sector and resolving state-level policy uncertainty.

Some of the key developments that could have a positive impact on the sector in 2020 are:

1 The revision of the oil and gas exploration policy and relaxation of environmental norms for oil and gas exploration.

2 The Cabinet has approved leasing out six airports of the Airports Authority of India in Ahmedabad, Jaipur, Lucknow, Guwahati, Thiruvananthapuram and Mangaluru for their operation, management and development through public-private partnerships.

3 Reports indicate that the Central Government intends to introduce an Ordinance in 2020 to restrict cross-subsidy surcharge, ensure timely payment of generation dues by Discoms and make PPAs non-negotiable.

4 India has set an ambitious target of developing 5 GW of offshore wind capacity by 2022, and a further 30 GW by 2030. The first offshore wind project with a capacity of 1 GW will be developed off the coast of Gujarat. The seabed leasing policy for offshore wind is likely to come into force this year, which should provide regulatory certainty to investors.

5 As land availability for grid-scale projects presents a challenge, floating solar projects are expected to take off in India, with MNRE planning capacity addition of 10 GW by 2022. The Damodar Valley Corporation is planning to install 100 MW of floating solar plants at its dams in Maithon, Panchet and Tilaiya, located in Jharkhand and West Bengal. Significantly, while floating solar plants can be set up on any freshwater surface, building them on the reservoirs of hydroelectric dams helps utilise existing transmission infrastructure and lower construction costs.

6 The Central Government recently opened the coal mining sector through the promulgation of the Mineral Laws (Amendment) Ordinance 2020. The Ordinance allows coal mining by any company present in sectors other than steel and power and does away with the end-use criteria which previously restricted bidders without self-consumption requirements from bidding for coal mines. This is expected to bring in investment into the Indian coal sector as well as reduce reliance on imports.

7 2020 should be an important year for the EV sector, with the introduction of several incentives for the purchase and manufacture of EVs, coupled with a policy push towards setting up charging infrastructure.

For a round-up of some of the key legal developments across sectors in 2019 and a brief insight on what to expect in 2020, please read our sector-wise updates, which can be accessed at: https://trilegal.com/knowledge-repository/page/2/?title=milestone

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